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257329—40

In the Supreme Court of the United States

OCTOBER TERM, 1940

No. 316

JACOB MEHRLUST, PETITIONER

v.

JOSEPH T. HIGGINS, INDIVIDUALLY AND AS COLLECTOR OF INTERNAL REVENUE FOR THE THIRD DISTRICT OF NEW YORK

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINION BELOW

The opinion of the District Court (R. 36–41) is reported in 30 F. Supp. 166. The opinion of the Circuit Court of Appeals (R. 47–49) is reported in 112 F. (2d) 717.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on July 3, 1940. (R. 50–51.) The petition for a writ of certiorari was filed on August 8, 1940. The jurisdiction of this Court is invoked

under Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether the taxpayer's transfer of his stock of jewelry to a newly formed, wholly owned corporation three days before the effective date of Section 605 of the Revenue Act of 1932 was effective to avoid the manufacturer's excise taxes assessed against the taxpayer under that section upon the subsequent sales of the jewelry.

STATUTES AND REGULATIONS INVOLVED

The statutes and regulations involved are set forth in the Appendix, *infra,* pp. 7–8.

STATEMENT

The material facts as stipulated (R. 27–34) and as found by the District Court (R. 37–39, 41) are as follows:

Section 605 of the Revenue Act of 1932 was enacted into law on June 6, 1932 and became effective on June 21 of that year. It imposed an excise tax of ten percent on sales of jewelry by a manufacturer, producer or importer.

Taxpayer, Jacob Mehrlust, who was engaged in the manufacture and sale of jewelry, had on hand on June 6, 1932 a stock of jewelry valued at $628,243. He organized a corporation, known as J. Mehrlust, Inc., on June 17, for 500 of whose 1,000 authorized shares of stock he paid into its

treasury $2,500 in cash. He thus became, and has since remained, the sole stockholder of the corporation and its only salaried officer. On June 18, the taxpayer sold to the corporation the stock of jewelry which he had on hand and took in exchange the company's demand note for $626,243, bearing no interest, and $2,000 in cash out of the $2,500 he had just paid in. The corporation paid the note in part by assuming a debt of the taxpayer in the amount of $235,000, which was owing to various banks. The corporation gave its notes, endorsed by the taxpayer, to the banks in place of the taxpayer's individual notes. (R. 37.)

After the transfer of the jewelry to the corporation, and after the effective date of Section 605, the corporation began to sell the jewelry as the taxpayer had done before. The clerical force and office space which it used were substantially the same as those previously used by the taxpayer as an individual. The corporation made no further purchases from the taxpayer, although it did make several purchases from others. The articles which it sold were invoiced under the corporate name on forms previously used by the individual, but to which was added a stamped "Inc.", which, in a few instances, was inadvertently omitted. Some checks came in payable to the corporation and some to the individual. Of the latter, some were endorsed by the individual and deposited in the corporate account and others were sent back to the customers to be redrawn. (R. 37–38.)

Some articles which were unsaleable were transferred back to the individual, who refabricated and sold them. Such retransfers were recorded in the stock book of the corporation with the notation "J. M.", sometimes accompanied by the legend "sold to" and at other times by the legend "charged to," but no entries were made in the corporation's sales book or the individual's purchase book and they were entered in the individual's journal under the designation "intercompany account". (R. 38.)

The corporation kept a complete set of books, maintained a separate bank account and filed separate tax returns. The taxpayer paid the operating expenses of the corporation in the first instance, but was then recompensed by the company. The corporation never had a telephone listing or a listing in the directory located in the lobby of the building in which it was situated. (R. 38–39.)

The Commissioner determined that the alleged sale from the taxpayer to the corporation "was not a bona fide transaction, but merely a scheme to escape tax liability" (R. 17), and accordingly ruled that the taxpayer was liable for a tax under Section 605 with respect to all sales by the corporation of jewelry acquired from the taxpayer. The taxpayer paid the tax under protest, filed a claim for refund which was rejected, and then instituted suit (R. 39). The District Court, holding that the sale from the taxpayer to the corporation was bona

fide, entered judgment for the respondent (R. 42–43). The court below reversed (R. 50).

ARGUMENT

The decision below is not in conflict with the decision of any other circuit court of appeals or with any decision of this Court and presents no question of importance. The issue is merely whether the rule of *Higgins* v. *Smith,* 308 U. S. 473, and *Griffiths* v. *Commissioner,* 308 U. S. 355, is applicable to the particular facts of this case; the decision of the court below that the rule does apply was plainly correct and, in any event, presents no occasion for further review.

There can be no dispute that, as the court below held, the corporation was "absolutely and immediately responsible" to the will of the taxpayer. Consequently, even though the corporation be deemed a separate legal entity which had legal title to the jewelry, its sales were, in every real sense, the sales of the taxpayer. The tax imposed by Section 605 is laid upon an act, the sale by a manufacturer; as the court below pointed out, the taxpayer could, and did, perform that act as much by means of his wholly owned and controlled corporation as though he had sold in his own name or in that of any other agent.

Petitioner alleges (Pet. 6–7) a conflict between the decision below and the decision of the Circuit Court of Appeals for the Tenth Circuit in *Continental Oil Co.* v. *Jones,* decided June 26, 1940, not

yet officially reported but found in 1940 C. C. H., Vol. 4, par. 9549. Far from being in conflict, the decisions are strikingly similar. There the taxpayer, which was a producer and manufacturer of lubricating oil, sought to avoid the impact of Section 601 (c) of the Revenue Act of 1932, which imposed an excise tax upon lubricating oil sold by a manufacturer or producer, by selling its lubricating oil prior to the effective date of Section 601 (c) to wholly owned and controlled corporations which were not producers or manufacturers. The court held, as the court below held in the present case, that under the decisions in *Higgins* v. *Smith, supra,* and *Griffiths* v. *Commissioner, supra,* the taxpayer was liable for the tax on subsequent sales of the oil made by the wholly owned corporations.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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SEPTEMBER, 1940.